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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

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In the Matter of Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act of 1992 Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming	CS Docket No. 95-61

COMMENTS OF TIME WARNER CABLE

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June 30, 1995

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Summary

Time Warner Cable ("TWC"), a division of Time Warner Entertainment Company, L.P. ("TWE") that operates cable television systems throughout the country, submits these comments in response to the Commission's Notice of Inquiry in this proceeding. 1/ TWC submits the following points:

- Clustering is procompetitive and is increasingly necessary for the survival of TWC and other cable operators.
- The concerns raised by the Commission concerning potential anticompetitive effects of clustering are unfounded.
- The Commission should coordinate and remain consistent with the policies and approaches of the Federal Trade Commission and the Department of Justice with respect to any concerns about the potential effects of horizontal concentration. Certainly, the Commission should not impose additional burdens on cable operators to respond to inquiries and document requests regarding this issue.
- The Commission's continuing assumption that vertical integration of cable operators and programmers has led to anticompetitive practices is unsupportable.

1/ The majority partner of TWE is Time Warner Inc. ("TWI").

- The evidence demonstrates not only that vertical integration is procompetitive, but also that it played a key role in the development of a wide range of programming choices.
- The Commission's program access, program carriage and channel occupancy rules have discouraged competition and diversity in video programming.
- It would be imprudent for the Commission to require the creation of a retail set-top market. The competitive process of testing consumer demand for a separate retail market has already begun on its own and government regulations designed to force acceleration of this process would be extremely risky. Such regulations could well result in security and "bad lock-in problems" that would impose substantial costs on both distribution network operators and consumers.

Introduction

In 1994, the Commission published its first annual report on the status of competition in the market for delivery of video programming ("1994 Report"). 2/ In the May 24, 1995 Notice of Inquiry in this docket ("1995 NOI"), the Commission solicited comments in preparation for its second annual report. TWC submits the following comments in response to that request.

The comments herein focus on three principal issues. First, we discuss the issue of clustering, which the Commission has raised in the context of its analysis of horizontal integration in the cable industry. Our position is that the Commission has understated the procompetitive benefits of clustering, and at the same time has incorrectly raised concerns about potential anticompetitive effects of clustering. Second, we discuss the issue of vertical integration. We object, in the strongest possible terms, to the Commission's continuing assumption that vertical integration has led to anticompetitive abuses by cable operators. We also take issue with the Commission's assertion that the rules it has adopted on the basis of that assumption are effective, necessary or lawful. Third, we discuss the possibility of the government taking steps to promote the development of a competitive retail market for

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2/ 9 FCC Rcd. 7442.

consumer-owned set-top boxes. The creation of such a retail market already has begun. The marketplace is best suited to determine whether such a market will fully develop considering all the possible benefits and significant problems with consumers owning their set-top boxes. The government should not dictate whether and how that market develops.

I. THE COMMISSION SHOULD TAKE NO ACTION TO DETER CLUSTERING, WHICH IS PROCOMPETITIVE AND ESSENTIAL TO CABLE'S SURVIVAL.

As the Commission has recognized, the clustering of cable systems benefits consumers in a variety of ways and ensures competition in the delivery of video programming. The 1994 Report explicitly recognized many of the benefits of clustering, but did not reflect the full significance of those benefits or the increasing importance of clustering to the survival of cable delivery systems. As we demonstrate below, the concerns about potential anticompetitive effects of clustering raised in the 1994 Report and the 1995 NOI are unfounded. In any event, the federal antitrust authorities have assessed the competitive implications of clustering transactions on an extensive and consistent basis, and the Commission should not replicate those efforts.

A. Clustering is a Procompetitive and Increasingly Necessary Strategy for TWC and Other Cable Operators.

In the 1994 Report, the Commission discussed numerous benefits of clustering, including: (1) economies of scale, which enable cable operators to provide better service at lower cost; (2) the ability of cable operators to compete with telephone companies in providing video, telephony and other services; and (3) the ability to provide advanced services such as video-on-demand. 3/ In the 1995 NOI, the Commission invited comments on the procompetitive benefits of clustering (¶ 82). In this section, we discuss those benefits and provide examples of how TWC has realized them.

1. Clustering creates economies of scale that benefit consumers by lowering costs and increasing quality.

Clustering enables TWC to realize economies of scale that result in dramatic improvements in its ability to provide quality service economically. The Commission identified many of the most obvious economies in the 1994 Report. 4/ Because clustering is the most efficient and cost-effective method of managing cable systems, it has been the cornerstone of TWC's cable strategy for many years.

Clustering not only benefits consumers by keeping costs down, it also improves the quality of cable service. At the technical level, the integration of clustered systems leads to more reliable signal transmission by enabling TWC to optimize the placement and use of headends, amplifiers and other system components. In addition, clustering has enabled Time Warner to operate its systems through decentralized teams of highly skilled, experienced and well-compensated managers at the regional level, which is more

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3/ See 1994 Report ¶¶ 151-53, 9 FCC Rcd. at 7518-19.

4/ See id. ¶ 151 (footnotes omitted), 9 FCC Rcd. at 7518.

effective than having scattered, lower paid, less qualified local teams report to distant middle management.

A more directly noticeable benefit results from the fact that clustering supports the investment required to produce high-quality original programming for local and regional audiences. For example, TWC subscribers in New York City--TWC's, and the nation's, largest cable cluster with approximately one million cable homes--can tune in to Time Warner's New York 1 News, a 24-hour all news network focused on local events. Also, like other original cable system programming, New York 1 provides a low-cost alternative for local advertisers.

2. Clustering is essential to TWC's ability to compete with other Multichannel Video Programming Distributors.

The rapid growth of alternative video providers, especially the telephone companies, has made clustering essential for TWC. TWC now competes with at least one MVPD in most areas, 5/ and with multiple Multichannel Video Programming Distributors in many others. TWC expects to face competition in the very near future from additional Multichannel Video Programming Distributors, including the

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5/ In the 1995 NOI, the Commission expressly amended its prior conclusion that "[i]n most of the local markets where cable operators provide cable service to subscribers, they remain the sole distributors of multichannel video programming" (1994 Report ¶ 141, 9 FCC Rcd. at 7513), stating that DBS and HSD are available "[i]n most franchise areas" (1995 NOI ¶ 75).

telephone companies. Those firms command powerful competitive advantages that TWC cannot hope to emulate, and with which TWC can only hope to compete through its clustering strategy.

In contrast to its competitors, the cable industry is "balkanized" into a patchwork of separately-owned cable systems in most major metropolitan areas. There are approximately 11,000 cable systems in the United States. By comparison, the seven RBOCs are geographically concentrated and can offer telephone services throughout virtually an entire regional operating territory. Thus, for example, the six contiguous states in which Bell Atlantic can provide telephone services to virtually all consumers located there is served by a large number of geographically dispersed cable operators whose individual systems are split into numerous small pockets. 6/

Each telephone company represents an enormous aggregation of capital and controls the local telephone business in a vast contiguous multistate region. For example, the smallest regional telephone company, Southwestern Bell, covers five states and has 13 million contiguous subscribers. Covering not only cities, but entire states and regions, the telephone operating

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6/ Broadcasting & Cable Yearbook 1994 D3-D64; Edmund Andrews, "With Merger's Failure, an Industry Seeks a Leader", N.Y. Times, Feb. 26, 1994, p. 39.

territories dwarf cable's largest cluster, TWC's New York cluster, which does not even serve all of New York City--much less the New York metropolitan area and Northeastern United States, all of which are served by NYNEX. Cable will be hard-pressed to compete with such firms, which already have access to much of the technology necessary to compete with cable in its core business, and have the wherewithal to mount a powerful resistance to cable's efforts to compete with them in their traditional businesses, unless it can achieve at least a minimally competitive scale through clustering. 7/

Other competitors also serve geographic areas far wider than even the most clustered cable systems. DBS firms, for example, enjoy a nationwide footprint, and the ability to manage the vast majority of their operations centrally. 8/ Similarly, broadcast television also serves a far greater region and reaches a larger number of

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7/ Ray Smith, CEO of Bell Atlantic, expressed disbelief that cable companies will be able to compete successfully with telcos: "But how successful are they likely to be? Consider that Philadelphia, for example, is served by maybe 10 or 11 cable companies. Even inside the city there are also four different cable companies . . . . Now you're telling me a consumer is going to subscribe with a cable-phone service that serves only one section of the city? That's going to be a pretty hard sale." Interview with Ray Smith: "Align and Conquer", Wired, Feb. 1995, 110, 115.

8/ See 1994 Report ¶ 69 & n.175, 9 FCC Rcd. at 7477.

neighboring viewers than cable. 9/ Cable operators cannot compete effectively for advertising dollars with broadcasters that have much greater "reach" unless cable operators can offer access to an audience more comparable in size to other advertising media. Clustering enables cable operators to provide a more practical alternative for some advertisers. Even in clustered systems, however, local cable advertising is now--and likely will remain--a minor competitor to traditional media. 10/

3. Clustering is an essential prerequisite to TWC's ability to compete in telephony.

In the 1994 Report, the Commission stated that "[c]lustering may also reflect the desire of cable operators to enter the telephone business". 11/ Time Warner Communications, TWC's sister company, has demonstrated its

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9/ For example, the New York City broadcast television ADI includes almost 7 million television homes compared to Time Warner's approximately one million subscribers in the same area. Thus, although Time Warner's New York cluster is the largest in the country, it is dwarfed by the reach of the broadcast stations.

10/ For example, Time Warner City Cable, which sells cable advertising on Time Warner's systems in the New York City area, earns only a tiny fraction of the revenues of New York's six major broadcast television stations, which together generate more than $1 billion each year. On a broader scale, cable accounts for less than two percent of the national spot advertising business, compared to an 82 percent share for broadcast television.

11/ 1994 Report ¶ 153, 9 FCC Rcd. at 7518.

desire to enter the telephone business through enormous investment and commitment over the past few years.

In cooperation with Time Warner Communications, TWC is actively working toward competition with the telephone companies in numerous areas. For example, Time Warner Communications recently announced plans to provide long-distance access service in New York City, local telephone service to residential customers in Rochester, New York, and local and access service throughout the State of Ohio, among other areas.

Clustering is particularly important to Time Warner's plan to offer telephone services. In order to compete in the telephone business, Time Warner must be able to operate in a geographic area large enough to make its service competitive with that offered by local telephone companies. Because telephone companies typically serve broad regions comprising the entire geographic areas of several states, 12/ they can:

- complete local calls on their own networks--if a cable company does not serve the entire metropolitan area, it must pay the local telephone company to complete at least some local calls;

- provide access service to long-distance carriers;

12/ For example, Bell Atlantic serves not only the entire Washington, Philadelphia and Baltimore metropolitan areas, it serves the entire states of Maryland, Virginia, West Virginia, Delaware, Pennsylvania and New Jersey.

- provide telephone service to all locations of a local business;
- make efficient use of advertising, which is sold on the basis of coverage of an entire metropolitan area;
- retain customers who move within the metropolitan area; and
- amortize capital investments over a large pool of customers.

In order to compete in the telephone business, it is critical for Time Warner to have the advantages of clustering, which the telephone companies already enjoy to a far greater extent.

Time Warner can provide technologically superior telephone service through its fiber optic networks that will benefit consumers in tangible ways. In order to realize such benefits, clustering is essential because of the huge investments in capital equipment that are required to make telephone service possible. That equipment includes alternative access network architecture, switching equipment and other technology that must be installed locally and can only be supported by a local customer base that is sufficient to generate enough revenues to recoup the investment in a reasonable time. A customer base of the scale sufficient to support such capital investments is not possible without the geographic coverage made possible by clustering. Such competition will benefit consumers in terms of price, quality and availability of telephone service.

4. Clustering is essential to TWC's ability to provide the next generation of telecommunications services.

In the 1994 Report, the Commission recognized that clustering could facilitate the development of such innovative services as video-on-demand, by justifying the enormous investment in technology necessary for such applications. 13/ An important part of TWC's business is to develop and provide advanced telecommunications services to its customers.

The Full Service Network is Time Warner's plan to make the "information superhighway" a reality for millions of Americans, consistent with the national policy of bringing access to information to the general public as rapidly as possible. Just as clustering is critical to the development of telephone service, it is also essential to make possible the range of other services planned for the Full Service Network. "On-demand" services require multi-million dollar investments in such technology as digital media servers and high-speed digital switching equipment.

13/ 1994 Report ¶ 152, 9 FCC Rcd. at 7518; see also id. ¶ 153, 9 FCC Rcd. at 7519 ("Future cable networks that offer multiple services (voice, video, and data) may require companies to serve larger markets in order to fully take advantage of economies of scale and scope.").

The Full Service Network's heavy investment in these new technologies for video communication is dependent not only on TWC's fiber-rich architecture but also most importantly on clustering, which makes investments in fiber and cutting-edge technology cost-effective.

B. The Concerns the Commission Has Raised About Potential Anticompetitive Effects of Clustering Are Unfounded. 14/

The foregoing discussion of TWC's strategy in creating clusters and enhancing existing clusters should answer the Commission request regarding TWC's reasons for several acquisitions and their effects (if any) on competition. 15/

In the 1994 Report, the Commission concluded that, although there are numerous potential procompetitive benefits of clustering, there are also potential anticompetitive effects. 16/ We submit that there is no basis for the concerns raised by the Commission. The concern that the acquisition of adjacent cable systems may

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14/ Just as TWC has added systems to its existing clusters, it has sold systems that do not fit well with those clusters. For example, in 1994, Time Warner disposed of cable systems in Mankato, Marshall and Montevideo, Minnesota; in Canon City, Thornton, Wheat Ridge and North Glen, Colorado; and in Council Bluffs, Iowa.

15/ 1995 NOI ¶ 81.

16/ *See* 1994 Report ¶¶ 151-55, 9 FCC Rcd. at 7518-19.

free cable systems from competitive constraints is unsupportable. Similarly, the concern that the development of regional clusters may deter entry is not only contrary to fact, but illogical. Moreover, the Commission's general concern about horizontal concentration is based on an unsupportable definition of the relevant product market.

1. The acquisition of adjacent cable systems does not remove a competitive constraint on cable systems.

In the 1994 Report, the Commission suggested that adjacent cable systems may be the "most likely entrants" in a particular location, and that the "elimination by acquisition of these potential competitors may increase the market power of clustered systems by decreasing the likelihood of entry". 17/ That theory is not supported by any evidence. Moreover, it is inconsistent with the decisions of the Federal Trade Commission to take no action on numerous acquisitions of large numbers of adjacent cable systems. 18/

The concern that acquisition of an adjacent cable system might have anticompetitive effects is based on the

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17/ 1994 Report ¶ 154, 9 FCC Rcd. at 7519.

18/ Time Warner's acquisitions of cable systems from KBLCOM, Summit and other firms and the Advance/Newhouse partnership transaction resulted in the consolidation of ownership of many adjacent cable systems. Despite that fact, and after the full review by the FTC of several of those transactions, the FTC declined to take any action to block or alter any of the transactions.

faulty assumption that the rates and service offerings of adjacent cable systems exert competitive pressure on one another. Yet the rates and service offerings of adjacent systems have no impact on pricing and service decisions of their respective operators. The principal reason is that with few exceptions adjacent systems cannot compete for the same subscribers. In most cases, a single company is authorized by a city or other political subdivision acting as a franchising authority to provide cable service within a geographic area. In those cases, an adjacent cable operator would be legally prohibited from serving subscribers in another cable operator's service area. As the Commission has found, even in cases where multiple cable operators are franchised to serve the same area, overbuilding has been "quite limited". 19/ Thus, adjacent systems do not have access to the same groups of customers and cannot compete for their business, either within their service areas or along their perimeters without franchise authorization.

19/ Overbuilding is uncommon because it is usually not economical for more than one operator to serve a franchise area. As the Director of the New York State Commission on Cable Television recently commented, although "a municipal government has the right to grant a second franchise . . . [it] just hasn't happened in New York State because of the economics of the industry". Peter Marks, "New Focus on Cable Competition", New York Times, Jan. 30, 1995, at B6 (discussing competition between cable and non-cable video service providers).

Given the usual one-operator-per-service-area situation, the rates and service offerings of adjacent cable operators can have no competitive effect on one another. A change in cable rates or services will not cause subscribers in an adjacent area to switch cable companies, because customers do not have access to both companies' services. Moreover, the rates and services of a cable system cannot be influenced by those of an adjacent system through the franchising process, because franchising authorities are prohibited by law from negotiating with cable operators on the level of rates.

2. Clustering does not deter entry by Multichannel Video Programming Distributors.

The Commission has expressed some concern that such activities as substantial capital investment and long-term commitment to serving a particular area by a cable operator will deter entry. Aside from the fact that such activities are generally to be encouraged, especially in the telecommunications area, there is simply no evidence of any link between such investments and commitments and a lack of entry by Multichannel Video Programming Distributors.

First, there has been no lack of entry. As the Commission has recognized, DBS firms have rolled out their services nationwide, LECs have begun to offer video services, and a host of other alternative firms have begun competing with TWC and other cable operators. 20/ That entry has occurred contemporaneously with large-scale investments by TWC and others in plant and capital equipment.

Second, to whatever extent entry might be deterred, that is largely explainable as the result of concerns about the telephone companies' entry into video distribution. The recent acquisitions of cable systems by Time Warner and other MSOs are largely the result of decisions by smaller MSOs and independent operators to exit. Those decisions have been based to a great extent on such firms' assessment that they do not have the wherewithal to compete with the massive resources and extensive access of the telephone companies.

Third, prohibiting TWC and other MSOs from clustering would jeopardize the entire cable industry. The Commission seems to suggest that preventing cable systems from clustering would encourage wireless firms to enter the market. 21/ Yet if a wireless firm could not enter an area served by a cluster of cable systems, surely it would not enter the same area were it served by an even more "clustered" LEC providing video programming. The Commission's suggestion seems to misapprehend the

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20/ See 1994 Report, 9 FCC Rcd. at 7462-92.

21/ Id. ¶ 151, 9 FCC Rcd. at 7518.

competitive dynamics of the video programming business: if cable firms are to survive competition with telephone companies, they must be able to cluster. Precluding clustering not only will not preserve the ability of wireless firms to compete, it will doom cable to an early defeat in the competition with the telephone companies.

We submit that the Commission's suggestion that "there may exist complex tradeoffs" (1994 Report ¶ 155) between the potential benefits and potential problems with clustering misses the forest for the trees. The competitive dynamics are in fact quite simple: entry by the telephone companies and other Multichannel Video Programming Distributors is occurring, and in the long term cable must cluster to survive. There is no complex tradeoff between pros and cons--clustering ensures competition, period. Without clustering, cable may not be able to survive as a viable competitor.

3. The Commission's general concerns about horizontal concentration are unfounded.

Time Warner recognizes that horizontal concentration can, in general, impede competition in a given market. However, there is no basis in any concern about horizontal concentration for the Commission to take any action to deter or discourage clustering transactions such as those mentioned above. First, the "cable television industry" is not a relevant product market for analysis of the extent or effects of horizontal concentration. Any meaningful analysis would necessarily include not only other Multichannel Video Programming Distributors, but also other firms that provide substitutes for video programming, including broadcast television, and a vast array of other entertainment and information sources.

Second, the antitrust laws provide safeguards against undue market concentration. Federal and state antitrust authorities have jurisdiction over such transactions, and have actively exercised that jurisdiction over clustering transactions. Thus, the Commission's analysis of particular clustering transactions at least to some extent replicates that of the antitrust authorities. Indeed, the discussion of horizontal concentration in the 1994 Report is based on the merger guidelines promulgated and applied by the FTC and the DOJ. 22/

Third, Commission action on horizontal concentration risks conflicting regulatory outcomes. The Federal Trade Commission took no action after reviewing Time Warner's acquisitions of cable systems from KBLCOM, Summit and several other firms, as well as the Advance/Newhouse partnership transaction. The FTC is currently reviewing Time Warner's proposed acquisition of cable systems owned by

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22/ See 1994 Report ¶¶ 142-46 & nn. 397 & 403, 9 FCC Rcd. at 7514-16, citing 1992 Horizontal Merger Guidelines, 4 Trade Reg. Rep. (CCH) ¶ 13,104.

Cablevision Industries Corp. Commission action on horizontal concentration could conflict with the antitrust authorities' actions on such transactions, which take into account the procompetitive aspects thereof. Given the requirement that the FTC and the DOJ vigorously enforce the antitrust laws, the Commission should coordinate with, and where appropriate defer to, those agencies with respect to clustering transactions. Such an approach would avoid the risk of conflicting outcomes, avoid imposing undue burden and expense on the parties to such transactions and avoid wasting government resources through duplicative inquiries, which often require costly production of documents and other materials to the antitrust agencies. Certainly the Commission should not require cable operators to respond to fact inquiries and document requests in areas already investigated or being investigated by the FTC and DOJ.

II. THE COMMISSION'S ASSUMPTION THAT VERTICAL INTEGRATION IS ANTICOMPETITIVE IS NOT SUPPORTED BY EVIDENCE.

The Commission assumes that vertical integration is anticompetitive. That assumption is not only unsupportable, it ignores the enormous importance of vertical integration in the development of the vast and ever-increasing array of cable programming choices available today. There is no evidence that the Commission's promulgation and enforcement of rules based on the perceived evils of vertical integration have been successful. Indeed, there is every reason to believe those rules have discouraged the development of cable programming.

A. <u>There Is No Evidence to Support the Commission's Continuing Assumption That Vertical Integration Results in Anticompetitive Practices.</u>

In the 1995 NOI, the Commission continues to assume that vertically integrated cable operators have "inhibit[ed] competitive entry into the programming supply and distribution markets" (¶ 84). Although the 1994 Report contained no evidence to support that assumption, the Commission has not even requested in the 1995 NOI any information that might provide such support.

Despite that lack of evidence, the Commission continues to base its policy on the unexamined assumption of anticompetitive practices. Absent any such evidence the Commission should re-examine the rules based on its assumption: the channel occupancy rules, the program access rules and the program carriage rules. At a minimum, the Commission should accord greater weight to the benefits of vertical integration.